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PART II

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Office of Education

■

STUDENT ASSISTANCE PROGRAMS

Proposed General Provisions

[4110-02]

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Office of Education

[45 CFR Part 168]

STUDENT ASSISTANCE PROGRAMS

Proposed General Provisions

AGENCY: Office of Education, HEW.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes, in subpart B, minimum standards regarding audits, financial responsibility, and administrative capability which an otherwise eligible postsecondary institution or school must meet to participate in the student financial assistance programs authorized under title IV of the Higher Education Act of 1965.

Supart C proposes rules dealing with institutional misrepresentation of the nature of its educational program, its financial charges or the employment of its graduates. The Commissioner of Education believes that institutional adherence to the requirements of the proposed rules will result in improved management of title IV student financial assistance funds.

DATES: Comments must be received on or before September 25, 1978. It would be extremely helpful if the comments refer to specific sections and are made sequentially.

Public hearings on these proposed regulations will be held in six cities at the addresses listed below. The date and time for each meeting is as follows:

September 11, 1978, Atlanta, Ga., and Boston, Mass., 10 a.m.
September 12, 1978, Dallas, Tex., and Chicago, Ill., 10 a.m.
September 14, 1978, San Francisco, Calif., 10 a.m.
September 15, 1978, Washington, D.C., 10 a.m.

ADDRESSES: Written comments should be sent to: Mr. William L. Moran, Division of Policy and Program Development, Basic Grants Branch/Policy Section, Room 4923, ROB 3, 400 Maryland Avenue SW., Washington, D.C. 20202. Comments will be available for public inspection in Room 4923, Regional Office Building 3, 7th and D Streets SW., Washington, D.C. from 8:30 a.m. to 4 p.m., Monday through Friday (except Federal holidays).

The public hearings will be held at the following locations:

September 11, 1978, Atlanta College of Art, Memorial Art Center, The Panel Room, 1280 Peachtree Street NE., Atlanta, Ga.; 10 a.m.
September 11, 1978, Boston University, Harold P. Case Physical Education Center, Eilbert Lounge, Babcock and Commonwealth Avenues, Boston, Mass.; 10 a.m.
September 12, 1978, University of Texas, Health Science Center, Building D1.600, 5323 Harry Heines Boulevard, Dallas, Tex.; 10 a.m.
September 12, 1978, University of Chicago, Cob Hall, Quantrell Hall Auditorium, 5811 South Ellis Avenue, Chicago, Ill.; 10 a.m.
September 14, 1978, University of San Francisco, University Center, Room 413, 2130 Fulton Street, San Francisco, Calif.; 10 a.m.
September 15, 1978, Regional Office Building 3, GSA Auditorium, 7th and D Streets SW., Washington, D.C.; 10 a.m.

To facilitate scheduling of speakers it woud be helpful if any person desiring to present his or her views orally at any of the scheduled hearings would inform the appropriate representatives listed below in advance of the hearing. If a prepared statement will be presented, the presenter is requested to file three copies with the representative either prior to or on the date of the hearing.

Ms. Judith Brantley, U.S. Office of Education, 101 Marietta Tower, Third Floor, Atlanta, Ga. 30323, 404-242-5010.
Mr. Thomas J. O'Hare, U.S. Office of Education, P.O. Box 8370, John F. Kennedy Federal Building, Boston, Mass. 02114, 617-223-7205.
Ms. Carol Sivright, U.S. Office of Education, 1200 Main Tower Building, Dallas, Tex. 75202, 214-729-2221.
Mr. Donald Aripoli, U.S. Office of Education, 300 South Wacker Drive, Chicago, Ill. 60606, 312-353-2508.
Mr. Jerry Craft, U.S. Office of Education, 50 United Nations Plaza, San Francisco, Calif. 94102, 415-556-0137.
Mr. William Moran, U.S. Office of Education, 400 Maryland Avenue SW., Washington, D.C. 20202, 202-245-1744.

FOR FURTHER INFORMATION CONTACT:

Mr. William Moran, 202-245-1744.

SUPPLEMENTARY INFORMATION:

NEED FOR REGULATION

The major student financial assistance programs administered by the Office of Education, namely basic grant, supplemental grant, college work-study, guaranteed student loan and national direct student loan programs, provided financial support to approximately 2.7 million students in the 1977-78 academic year. The loans made or insured under the guaranteed student loan program amounted to over $1 billion, the grants awarded under the basic grant program amounted to over $1.7 billion, and approximately $1 billion has been disbursed under the three campus based programs. For the 1978-79 academic year, financial assistance under these programs will, it is anticipated, amount to approximately $3.7 billion.

As a result of the magnitude of this assistance and the rising concern over the misuse and abuse of these Federal student financial aid programs by institutions and schools, and the rise in the default rate for the guaranteed and national direct student loan programs, the Congress in the recently enacted Education Amendments of 1976, Pub. L. 94-482, authorized the Commissioner of Education to prescribe such regulations as may be necessary to provide for—

(1) A fiscal audit of an eligible institution with regard to any funds obtained by it under title IV programs or obtained from a student who has a loan guaranteed or insured under title IV; and

(2) The establishment of reasonable standards of financial responsibility and appropriate institutional capability for the proper administration by an eligible institution of title IV student financial aid programs.

Prior to the enactment of this section (section 497A of the Higher Education Act), the Commissioner's specific authority to prescribe standards was restricted to institutional participation in the guaranteed student loan program.

The statute also provides that the Commissioner may suspend or terminate an institution's participation in title IV programs upon a determination that it has engaged in substantial misrepresentation of the nature if its educational program, its financial charges, or the employability of its graduates.

As background for these provisions, the House report leading to the Education Amendments of 1976 discussed the need for the provisions, stating that:

> The bill also includes provisions that will increase the level of accountability for student assistance funds that are obtained directly or indirectly by an institution of higher education * * * These additions to current law are intended by the committee to provide the Commissioner with the necessary tools to keep unethical individuals from engaging in unlawful conduct and sharp practice in the name of helping financially disadvantaged students to obtain the education necessary to succeed in the economy of the 1970's. H. Rept. No. 1086, 94th Congress 2d Sess. p. 13.

In the same vein, the Senate report stated:

> The Education Amendments of 1972 authorized the Commissioner to limit, suspend, or terminate institutional participation in the guaranteed student loan program, in a provision similar to that in the committee bill. After a number of years, the Office of Education has finally issued regulations to implement that provision, and the committee hopes that it will have a significant effect in weeding out those schools which do not have the fiscal stability or administrative competence to participate successfully in the loan program. The commit-

tee bill would extend this protection to the basic grant, work-study, and direct student loan programs.

Without the language of the committee bill, the Commissioner has no statutory authority to withhold payments from a school that he knows is foundering and will not be able to provide its students their education, after its cost has been paid. It makes little sense to the committee to require continued payment of Federal funds to an institution in financial crisis, which threatens to close its doors and leave its enrollees stranded. The committee bill would allow the Commissioner to set fiscal standards, then suspend, limit, or terminate an institution's participation if it failed to meet them, after notice and hearing. S. Rept. No. 94-882, 94th Congress 2d Sess. p. 33.

Some of the specific concerns that gave rise to these provisions were reported in an Office of Education sponsored study, completed in October 1976 by the American Institutes of Research. That study revealed that misleading recruiting and admission practices, misleading advertising, lack of institutional financial stability, lack of adequate recordkeeping practices, inequitable refund policies, and the failure to make timely tuition and fees refunds were some of the more prevalent institutional abuses that affected the integrity and effectiveness of the aid programs.

Another major concern giving rise to these statutory provisions was the increase in the default rate in the national direct and guaranteed student loan programs. For example, Federal obligations to cover loans defaulted under the guaranteed student loan program soared from $31 million in 1972 to $177.5 million in 1976, representing nearly a sixfold increase during a period when loan volume remained relatively stable.

The Commissioner has proposed the standards set forth in this regulation (1) to curb and hopefully eliminate fraud and abuse in the title IV student assistance programs by institutions, schools, and students, and (2) to increase the level of accountability for student assistance funds administered by institutions of higher education and vocational schools.

The proposed standards for administrative capability, which were developed with the assistance of the HEW audit agency, reflect the practices and policies being followed by institutions which have sound procedures for the administration of title IV programs and should serve to assist other schools in developing good procedures. The standards, therefore, set forth a model set of procedures and establish parameters within which appropriate institutional policies may be drafted and implemented without Federal intervention. The standards of financial responsibility are intended to assure that an institution will be financially able to provide the education that its students have paid for.

When these rules go into effect, all institutions must comply with the requirements contained in them. The Commissioner anticipates that over a 3-year period each institution already paticipating in any of the title IV programs will be reviewed to determine whether the institution complies with these requirements. Institutions seeking eligibility will be evaluated in terms of these requirements before they are determined eligible for title IV programs. For the new institutions and for the institutions already eligible who are the first to be reviewed, compliance will be based primarily on the establishment of appropriate policies and procedures. However, after a reasonable period, the Commissioner will evaluate currently eligible institutions, and will reevaluate new institutions and those currently eligible institutions that were the first to be reviewed, on the basis of actual performance. Thus, for example, a consistent failure by an institution over an extended period to properly calculate student awards would indicate that the institution does not, in fact, have adequate personnel to administer student financial aid funds, as required by § 156.15.

The following is a discussion of the major provisions of the proposed regulation.

Audits and Recordkeeping

The regulations do not set forth any new audit requirements but cross-reference requirements already contained in existing program regulations. With respect to records, the only major new requirement is that institutions keep admission records that reflect the education and other relevant qualifications of each student admitted. (§ 168.12(c).) These records are necessary to enable the Commissioner to determine whether the institution satisfies the statutory definition of an institution of higher education, proprietary institution of higher education, or vocatioal school. For example, such records would show whether nonhigh school graduates admitted to a public junior college have the ability to benefit from the training offered, and whether that student is above the age of compulsory school attendance.

Additionally, institutions would be required to maintain a separate bank account for Federal funds received under the national direct student loan, college work-study, supplemental educational opportunity grant, and basic educational opportunity grant programs which are to be disbursed to students. This regulation would supersede the current program regulations which provide that physical segregation of cash depositories for Federal student aid funds is not required. In accordance with current practice, however, separate bank accounts would not need to be maintained for each individual program, provided adequate fiscal records for each program are maintained.

Another new requirement is that institutions make records readily available for review at the geographical location where students will receive their degree or certificate. Thus multicampus institutions do not have to keep records at each branch campus. However, when requested, they must make such records available at the particular institution being reviewed by the Commissioner.

Factors of Financial Responsibility

The standards regarding financial responsibility (§ 168.14) are formulated to assure that a student who enrolls at an institution or school will receive the education he is paying for. The bonding requirement is proposed in response to several incidents where student assistance funds were embezzled by employees of an institution.

Institutions are accountable to the Federal Government for any loss of funds as a result of the funds being stolen or embezzled by school employees. The proposed regulation would require institutions to bond each individual disbursing title IV funds in an amount equal to 10 percent of funds disbursed by the institution each academic year. Thus the proposed regulation would provide protection to the institution as well as the Federal Government. Because of the cost of bonding, it was decided to limit the bonding to 10 percent of the funds disbursed.

Performance bonding was considered, but upon investigation, this requirement was not retained because its cost would be prohibitive.

Administrative Capability

With regard to one of the requirements contained in this section (§ 168.15) that an institution use "an adequate number of qualified persons" to administer program funds, the Office of Education invites particular comment as to what would constitute an "adequate" number of such personnel and what factors should be considered in making this determination.

The Education Amendments of 1976 set forth a new requirement: that students must maintain satisfactory academic progress according to the standards and practices of the institution (section 497(e) of the Higher Education Act). The Commissioner will include in his determination of an institution's capability to administer title IV funds, whether the institution has established and applies "reasonable" standards in measuring satisfactory progress of student aid recipients. The

purpose of this provision is to cope with the so called "professional" student and students who attend school only to obtain financial aid.

INSTITUTIONAL REFUNDS

One means of measuring whether an institution is capable of administering title IV funds and is financially responsible to its students is by examining its refund policy. This notice of proposed rulemaking does not include proposed regulations concerning institutional refund policies. Rather, through this notice the Commissioner of Education is soliciting public comment on the subject before any proposed regulations are drafted. Commenters are requested to bring to our attention examples of institutional abuse of Federal student aid programs, if any, which they believe have been caused by an institution's refund policy or lack thereof. Commenters should also indicate whether they feel such abuses could be curbed by regulations, and, if so, what requirements those regulations should contain. All comments received on this issue will be studied carefully before any proposed regulations are drafted and submitted for public comment. (It should be noted that the institution's refund policy is included in § 178.4 of the student consumer information services regulations (45 CFR 178.4) as one of the items on which information is to be made available to students.)

ATTRIBUTION OF INSTITUTIONAL REFUND, AND REPAYMENTS OF CASH DISBURSEMENTS MADE DIRECTLY TO THE STUDENT

1. ATTRIBUTION OF INSTITUTIONAL REFUND

When a student's institutional charges were paid with funds from Title IV programs, other than the college work-study program, any institutional refund must be apportioned among the various sources of funding which were used to pay the charges originally. Paragraphs (a) through (c) of § 168.17 deal with the method of computing this apportionment. Since a student is not expected, of course, to return earnings for work performed, the issue of apportionment of the institutional refund concerns only the grant and loan portions of the student's package which had been awarded to meet costs for an entire term or payment period.

Two methods of computing the apportionment of the institutional refund were considered in drafting the proposed regulation. They differ primarily in their treatment of the expected family contribution. The first method assumes that the expected family contribution and the various components of the student's aid package are expended at the same rate in meeting the student's educational costs. The second method, applying the principal that any need-based financial aid is supplemental to the expected family contribution, assumes that the family contribution is expended fully before any financial aid funds are used.

Thus, under the first method a portion of the refund will be attributable to the expected family contribution whenever there is an expected family contribution of any amount. Under the second method a portion of the refund would be attributed to the family contribution only when the amount of the refund exceeded the amount of the grant and loan portions of the student's aid package.

In drafting the proposed regulation, the Commissioner has adopted the first method. However, he is soliciting comments on the alternative as well as on the method set forth in the proposed rule.

The method set forth in § 168.17 of the proposed rule assumes that the family contribution and each of the grant and loan components of the student's aid package were applied toward the student's educational costs in the same proportion that each represents as part of an aggregate amount. Therefore, the institutional refund is allocated among these various funding sources in proportion to their original share of the aggregate.

The following example shows the apportionment of an institutional refund of $500 in a case in which the family contribution plus the grant and loan portions of the aid package totaled $2,000.

Funding	Cost	Percent of cost	Allocation of refund to—	
Family contribution	$450	22.5	Student	$112.50
BEOG	250	12.5	BEOG account	62.50
SEOG	750	37.5	SEOG account	187.50
Loan (NDSL or GSL	550	27.5	Loan account*	137.50
Total	2,000	100.0		500.00

*In the case of a National Direct Student Loan, the portion of the refund attributable to the loan would be applied as a reduction of the principal balance in the student's loan account at the institution. In the case of a Guaranteed Student Loan, the portion of the refund attributable to the loan would be paid by the institution to the lender.

The alternative method assumes that the family contribution should be expended in its entirety before any student financial aid funds are expended. Thus, student-owed refunds are attributed to the various nonwork sources of financial aid until the original amounts have been completely restored before any funds are returned to the family. If the amount of money being refunded exceeds the amount of nonwork financial aid which was provided to the student and to the student's account, the excess is returned to the family. On the other hand, if the amount of money being refunded is equal to or less than the amount of nonwork financial aid provided to the student or to the student's account, the entire amount being refunded is allocated among those sources of aid in proportion to their shares of the original aggregate amount of nonwork financial aid provided to the student or to the student's account.

In the example cited below, using the same figures as in the previous example, the cost is $2,000, the grant-loan components of the student's aid package totaled $1,500, and the institutional refund was $500. Therefore, the entire amount of the institutional refund would be allocated to the appropriate student aid accounts in the following manner:

Funding source	Grant loan components	Percent of total grant/loan aid	Allocation of refund to—	
BEOG	$250	16.1	BEOG account	$80.50
SEOG	750	48.4	SEOG account	242.00
Loan (NDSL or GSL)	550	35.5	Loan account*	177.50
Total	1,550	100.00		500.00

* In the case of a National Direct Student Loan, the portion of the refund attributable to the loan would be applied as a reduction of the principal balance in the student's loan account at the institution. In the case of a Guaranteed Student Loan, the portion of the refund attributable to the loan would be paid by the institution to the lender.

Under the first method described above, the student is due a portion of the institutional refund resulting from an unexpended portion of the expected family contribution. However, under the following circumstances the student may not receive any money.

As discussed under item 2 below, a student may have received an overpayment of aid funds as a result of receiving a cash disbursement for noninstitutional charges. In such a case the amount due to the student from the institutional refund would be applied against that overpayment before any of these funds were returned to the student.

In applying for a guaranteed student loan, the student may have agreed to assign a portion of a refund due to him or her to the lender for reduction of the principal balance of the loan. Therefore, even though the student did not owe a repayment of a cash disbursement for noninstitutional charges, the portion of the refund attributable to the expected family contribution might not be returned to him or her since it may be assigned to the lender to reduce the principal guaranteed student loan balance. Thus, the student would not receive a cash refund from the institution until all overpayments were settled and any amount assigned to reduce a guaranteed student loan balance had been returned by the institution to the lender.

Under the alternative method, offsets resulting from an unexpended portion of the expected family contribution would usually not occur, and the student would owe back to the institution a larger portion of the financial aid disbursed to him or her for living expenses.

2. ATTRIBUTION OF REPAYMENTS OF CASH DISBURSEMENTS MADE DIRECTLY TO THE STUDENT

Paragraph (d) of § 168.17 is intended to provide a means of determining if a repayment is due from any cash disbursement of aid for noninstitutional charges if the student leaves that institution before the end of the payment period for which the cash disbursement was made.

In determining whether a repayment is due, the institution will, of course, need to know the date the student left the institution. If the student officially withdrew or was expelled, the date he or she ceased to be in attendance will be a matter of institutional record. If the student simply left the institution without completing official withdrawal procedures (i.e., unofficially withdrew) and no specific date for his or her departure is known, the institution should use its best judgment in determining the date the student ceased to be in attendance in order to compute the portion of a cash disbursement which should be considered as already expended during his or her period of attendance.

The proposed regulation provides that the institution itself shall determine the amount of the total cash disbursement which should be considered "unused" as of the date the student leaves the institution, taking into consideration reasonable expenses which the student would have incurred during his or her period of attendance for items which were not paid to the institution. (It is assumed that any institutional refund policy would take into account any amounts paid to the institution in cash as well as amounts credited to the student's institutional account.) The proposed regulation cites a number of types of expenditures which could be considered but does not limit the institution's discretion to include others. After the institution has determined the total amount of the cash disbursement which it considers unused as of the date the student ceased to be in attendance, the portion of the overpayment to be attributed to each grant and loan program shall be made in accordance with the following ratio:

(Amount to be attributed to each program/total amount of cash disbursement determined by the institution to be an overpayment) : (amount provided by each program for the period for which aid was awarded/student's cost of education for the period for which aid was awarded, minus amount of student earnings during the period).

This procedure parallels that set forth in § 168.17(a) for determining the attribution to program accounts of an institutional refund. Expressed as equation, the ratio appears as:

Amount to be attributed to each program = (amount provided by each program for the period for which aid was awarded/student's cost of education for the period for which aid was awarded, minus amount of student earnings during the period) × total amount of cash disbursements determined by the institution to be an overpayment.

On April 8, 1977, a notice of proposed rulemaking was published in the FEDERAL REGISTER which discussed the issue of attribution of repayments from cash disbursements made directly to the student when the student leaves the institution before the completion of the period for which the funds were awarded. In that notice a formula was proposed, to be inserted in § 176.14 of the supplemental grant regulations and § 190.77 of the basic grant regulations, for calculating the portion of a grant disbursement which should be considered an overpayment subject to repayment by the student. There was a general consensus among the commenters that the formula did not allow sufficient flexibility for the institution to take into consideration the circumstances of individual students in determining the amount of a cash disbursement which should be repaid. In response to the commenters' concern, the proposed formula has been discarded. In its place we have substituted the procedure set forth in § 168.17(d), and described above, in which the institution has discretion in determining the portion of a cash disbursement which it considers "unused" as of the date the student withdraws. The portion of the "unused" amount which should then be considered an overpayment for each specific grant program is then determined by the simple proportional ratio set forth in the regulation.

ADDITIONAL FACTORS

Section 168.18 sets forth conditions which the Commissioner views as warning signals regarding whether an institution is capable of continuing its participation in title IV programs. This section is based upon § 177.66 of the existing GSL program regulations. (45 CFR 177.66) However, the benchmark default and withdrawal rates have been revised upward and the default provision has been extended to include national direct student loans as well as guaranteed student loans.

An additional distinction should be made between factors of financial responsibility contained in § 168.14 and those additional factors for evaluating administrative capability and financial responsibility found in § 168.18.

The items contained in § 168.14 are conditions which an institution must meet in order to gain or maintain program eligibility. Failure to meet these provisions will be grounds for refusal to allow initial program participation or for the initiation of limitation, suspension, and termination actions. Failure to meet the requirements of § 168.18 may be grounds for denial or limitation, suspension, and termination actions at the Commissioner's discretion; and the Commissioner may require corrective action before extending program eligibility.

SPECIFIC COMMENTS AND RESPONSES

In October 1976, the Congress enacted and the President signed into law the Education Amendments of 1976. On November 29, 1976, the Commissioner published in the FEDERAL REGISTER (41 FR 52417) a notice of intent to issue regulations in order to solicit early public participation in the rulemaking process.

Five public conferences were held across the country between December 13 and 17, 1976, and comments made at those conferences were considered

in developing the proposed rule. Written comments were also received through December 30, 1976 and were considered in the development of this proposed rule. The following is a summary of these comments and the Commissioner of Education's response.

Comment: One commenter said that an audit should not be so comprehensive as to verify the propriety of each Federal dollar an institution spends. It should, however, be sufficiently comprehensive to establish that financial control systems are adequate and functioning effectively and that the institution is in compliance with Federal law and regulations.

Response: The Commissioner agrees. The proposed rule provides that audits are to be conducted in accordance with applicable title IV program regulations and audit guides.

HEW audit guides are presently available for the supplemental educational opportunity grant, college work-study, and national direct student loan programs. The Office of Education anticipates that an audit guide will be available for the Basic Educational Opportunity Grant Program by the time these proposed rules are published as final regulations. No audit guide is presently being contemplated for the guaranteed student loan program.

Comment: Comments received relative to the desirable frequency of fiscal audits ranged from annual to 2, 3, or 5 years. Additionally, special audits were recommended whenever (i) there was a change in ownership, (ii) the institution was the subject of continued complaints by student consumers, or (iii) there was evidence that funds were being misused. One commenter suggested that the Inspector General of DHEW be authorized access to all fiscal records of an institution at any time.

Response: Under existing title IV program regulations, audits are to be conducted at least once every 2 years. The proposed regulations provide that this frequency be maintained under normal circumstances.

The Inspector General has access to all relevant records under Section 205 of Pub. L. 94-505.

Comment: Several commenters suggested that audit standards (i) parallel the American Insitutie of Certified Public Accountants (AICPA) audit guide, (ii) be mutually agreed upon by HEW and the National Association of Colleges and University Business Officers (NACUBO) and (iii) follow the standards for audit of governmental organizations, programs, activities and functions (GAO), and the accounting, recordkeeping and reporting by colleges and universities for federally funded student financial aid programs, HEW, 1974.

Response: The regulation proposes that audits be conducted in accordance with the standards for audits of government organizations, programs, activities and functions (GAO), and the existing title IV program regualtions. As noted above the HEW audit agency has developed audit guides which were developed in association with the American Institute of Certified Public Accountants for the college based programs.

Comment: Relative to standards of financial responsibility and institutional capability, one commenter recommended that institutions be required to have the capability of meeting all reporting requirements and maintain supporting documentation for all awards.

Response: The regulations set, as a condition of eligibility, requirements for an institution's recordkeeping capability, including a requirement that it keep systematically organized records relating to all title IV transactions.

Comment: Relative to who is to conduct required audits, several commenters made the following recommendations: (i) That audits be performed by the university system of auditors when an institution is associated with such a public system or, in the case of institutions not associated with a public system by HEW auditors; and (ii) That audits be conducted by the institution using CPA firm and Federal guidleines.

Response: The regulation permits the instituion to choose who is to conduct audits. It requires only that the individual chosen be sufficiently independent of those who authorize the expenditure of Federal funds and that the individual comply with the GAO standards for audit of governmental organizations, programs, activities, functions, and existing title IV program regulations.

Comment: One commenter recommended that non-public institutions should be required to post a bond sufficient to assure performance.

Response: The Commissioner disagrees. Performance bonding was found to be prohibitively expensive. However, the Commissioner has requred a bond on personnel handling title IV funds to the extent of 10 percent of the title IV funds disbursed by an institution in an academic year.

Comment: Several comments were received concerning possible misrepresentation by an institution of the nature of its educational program, its financial charges or the employability of its graduates. One commenter suggested that the audit should be comprehensive enough to demonstrate that the institution had (i) clearly stated and measurable objectives, (ii) the capacity and resources to meet those objectives, and (iii) sufficient financial stability to give some protection to the student consumer.

Response: The suggestion with respect to (i) and (ii) cannot be adopted since the Commissioner's statutory authority is restricted to the administration and financial responsibility of student aid programs under title IV.

One commenter suggested that the term "misrepresentation" need not be defined. Another suggested that a definition of the term include misrepresentations such as the listing of fields of study not actually offered by the institution, or descriptions of facilities and services that do not exist.

Response: The Commissioner believes that a definition is necessary and has defined both the terms "misrepresentation" and "substantial misrepresentation" in § 168.32. The Commissioner has also addressed the concerns suggested by the second comment in § 168.33.

Other Information

NOTE.—The Office of Education has determined that this document does not contain a major proposal requiring preparation of an inflation impact statement under Executive Order 11821 and OMB Circular A-107.

Dated: January 27, 1978.

ERNEST L. BOYER,
U.S. Commissioner of Education.

Approved. July 22, 1978.

HALE CHAMPION,
Acting Secretary of Health, Education, and Welfare.

Chapter I of Title 45 of the Code of Federal Regulations is amended by reserving subpart A and adding subparts B and C of part 168 to read as follows:

PART 168—GENERAL PROVISIONS RELATING TO STUDENT ASSISTANCE PROGRAMS

Subpart A—General

Sec.
168.1 Scope and purpose [Reserved]
168.2 Definitions [Reserved]

Subpart B—Standards Relating to Audits, Records, Financial Responsibility, Administrative Capability and Institutional Refunds

168.11 Scope and purpose.
168.12 Audits, records, and examination.
168.13 Audit exceptions and repayments.
168.14 Factors of financial responsibility.
168.15 Standards of administrative capability.
168.16 [Reserved]
168.17 Attribution of institutional refunds and repayments of cash distributions made directly to the student.
168.18 Additional factors for evaluating administrative capability and financial responsibility.

Subpart C—Misrepresentation

168.31 Scope and purpose.
168.32 Special definitions.
168.33 Nature of educational programs.
168.34 Nature of financial charges.

Sec.
168.35 Employability of graduates.
168.36 Endorsements and testimonials.
168.37 Procedures.
Appendices A-C.

AUTHORITY: Sec. 497A, Higher Education Act of 1965, as added by sec. 133 of Pub. L. 94-482, 90 Stat. 2150-2151 (20 U.S.C. 1088f-1), unless otherwise noted.

Subpart A—General [Reserved]

Subpart B—Standards Relating to Audits, Records, Financial Responsibility, Administrative Capability and Institutional Refunds

§ 168.11 Scope and purpose.

This subpart sets forth standards which an otherwise eligible institution—that is, an institution of higher education satisfying the statutory definitions set forth in sections 435(b), 491(b), or 1201(a) of the Higher Education Act (HEA) or a vocational school satisfying the definition in section 435(c) of the HEA—must meet in order to participate in the student financial assistance programs authorized under title IV of the act. The standards concern the conduct of audits, the maintenance of records, financial responsibility, administrative capability, and institutional refunds. Noncompliance with these provisions may subject an otherwise eligible institution to proceedings under subpart II which may lead to a limitation, suspension or termination of its eligibility for title IV programs. (20 U.S.C. 1088f-1.)

§ 168.12 Audits, records, and examination.

(a) If an institution participates in the supplemental educational opportunity grant program, 45 CFR Part 176, college work-study program, 45 CFR Part 175, national direct student loan program, 45 CFR Part 144, basic educational opportunity grant program, 45 CFR Part 190, or guaranteed student loan program, 45 CFR Part 177, it must comply with the regulations for those programs concerning (1) audits of institutional transactions, (2) recordkeeping, and (3) a separate bank account for Federal funds received under these programs.

(b)(1) Audits must be conducted by individuals who are sufficiently independent of those authorizing the expenditure of Federal funds to produce unbiased opinions, conclusions or judgments. The independence of these individuals shall be judged in accordance with the criteria set forth in part III, chapter 3 of the U.S. General Accounting Office publication, standards for audit of governmental organizations, programs, activities, and functions. Additionally, auditors other than employees of a State or local government must meet the qualifications criteria set forth in appendix I of the GAO document. (These documents are included as appendix A and appendix B of this part.)

(2) Any individual or firm conducting an audit described in this section must give the Director of the HEW audit agency or the Commissioner access to records or other documents as may be necessary to review the results of the audits.

(c)(1) With respect to each title IV financial aid recipient, an otherwise eligible institution must establish and maintain on a current basis student records regarding:

(i) The student's admission to, and enrollment status at, the institution;

(ii) The program and courses in which each recipient is enrolled;

(iii) Whether the student is making satisfactory progress toward completion of the course of study the student is pursuing according to the standards and practices of the institution;

(iv) Any refunds due or paid the student; and

(v) The student's placement by the institution in a job if the institution provides a placement service and the student uses that service.

(vi) Amounts of financial aid from title IV programs received by the student at the institution and at any institutions the student previously attended. The institution must provide a copy of this record to any institution to which the student transfers at the request of that institution or the student.

(2)(i) With respect to each student enrolled at the institution, an otherwise eligible institution must establish and maintain records regarding the educational qualifications of that student as they relate to the admissions requirements of the institution.

(ii) With respect to those institutions where the entire institution has not been determined eligible, the institution must establish and maintain records regarding the educational qualifications of each student as they relate to the admissions requirements of those particular programs which have been determined eligible.

(3) Records must be (i) systematically organized and (ii) readily available for review by the Commissioner at the geographical location where the students will receive their degrees or certificates of program or course completion.

(d) An institution must deposit all Federal funds it receives under the supplemental educational opportunity grant, college work-study, national direct student loan, and basic educational opportunity grant programs in an account which does not include non-Federal funds or Federal funds from other programs. This account is subject to audit by the Commissioner at such reasonable times as the Commissioner will determine.

(20 U.S.C. 1088f-1.)

§ 168.13 Audit exceptions and repayments.

(a) If the Hew audit agency questions an expenditure or the institution's compliance with any applicable requirements as a result of its own audit or an audit performed at the direction of the institution, the Agency notifies the Commissioner and the institution of the questioned expenditure or procedure. If the institution believes the expenditure or procedure was proper, it shall notify the Commissioner in writing of its position and the reasons therefor. The institution's response must be received by the Commissioner within 35 days of the date of the audit agency's notification to the institution.

(b) Based on the audit finding and the institution's response, the Commissioner will determine the amount of funds improperly spent, if any, and will instruct the institution as to the manner of repayment. The institution must repay those funds within 60 days of the Commissioner's notification, unless the Commissioner permits a longer repayment period.

(20 U.S.C. 1088f-1.)

§ 168.14 Factors of financial responsibility.

(a) An otherwise eligible institution must be financially able to—

(1) Provide the educational services stated in its official publications and statements;

(2) Provide the administrative resources necessary to comply with the requirements set forth under this subpart; and

(3) Meet all its financial obligations including refunds.

(b) An otherwise eligible institution must bond each individual disbursing title IV funds at the institution in an amount equal to 10 percent of the title IV funds disbursed by that institution each academic year.

(c) If the Commissioner has reason to believe that an institution is unable to meet the requirements set forth in paragraph (a) of this section, or if the institution changes ownership, the Commissioner may require the institution to submit for its latest fiscal year a financial statement or an audit prepared by a State or local audit agency for a public institution, or certified by a certified public accountant or licensed public accountant for a nonpublic institution. The financial statement must include a balance sheet and an operating statement (profit and loss statement covering both income and expenses).

(20 U.S.C. 1088f-1.)

§ 168.15 Standards of administrative capability.

In order to participate in a title IV student financial aid program, an otherwise eligible institution must have the capability to adequately administer those programs. The Commissioner will consider an institution as having that capability if it establishes and maintains required student and financial records and if it:

(a) Designates a capable individual to be responsible for administering all the title IV programs in which it participates;

(b) Uses an adequate number of qualified persons to administer those programs. In determining whether an institution uses an adequate number of qualified persons, the Commissioner will consider the number of students aided, the number and type of programs in which the institution participates, the number of applications evaluated, and the amount of funds administered;

(c) Administers title IV programs in such a manner as to provide for an adequate system of internal controls. These internal controls must provide for a system of checks and balances under which no person will be directly responsible for all aspects of the programs. The functions of authorizing payment and disbursing funds shall be divided so that no office has the responsibility for both functions with respect to any particular student aided under the program;

(d) Establishes and applies reasonable standards for measuring whether a student receiving aid under any title IV program is maintaining satisfactory progress in the course of study the student is pursuing;

(e) Develops an adequate system to verify the consistency of the information it receives from different sources with respect to a student's application for financial aid under title IV programs. In determining whether the institution has an adequate verification system, the Commissioner will consider whether the institution reviews:

(1) All student aid applications, needs analysis documents, and eligibility notification documents presented by or on behalf of each applicant;

(2) Any documents, including any copies of State and Federal income tax returns which are normally collected by the institution to validate information received from other sources; and

(3) Any other information normally available to the institution which bears on a student's citizenship, previous educational experience or other factors relating to a student's eligibility for title IV funds; and

(f) Provides adequate financial aid counseling to eligible students who apply for title IV aid. In determining whether an institution provides adequate counseling, the Commissioner will consider whether its counseling includes information regarding:

(1) The source and amount of each type of aid offered;

(2) The method by which aid is determined, and disbursed or applied to a student's account; and

(3) The rights and responsibilities of the student with respect to enrollment at the institution and receipt of financial aid. Such information includes the institution's refund policy, its standards of satisfactory progress, and other conditions that may alter the student's aid package.

(20 U.S.C. 1088f-1.)

§ 168.16 [Reserved]

§ 168.17 Attribution of institutional refunds and repayments of cash disbursements made directly to the student.

(a)(1) If a refund is due to a student under the institution's refund policy and the student received financial aid under any student financial aid program authorized under title IV, a portion of that refund must be attributed to each program, except the college work-study program, from which the student received funds.

(2) If the student received a basic grant, a portion of the refund must be restored to the institution's basic grant account or to the Commissioner. If the student received a supplemental grant, a portion of the refund must be restored to the institution's supplemental educational opportunity grant account. If the student received a national direct student loan and/or a guaranteed student loan, a portion of the refund must be used to reduce the principal on those loans.

(3) The amount to be restored to each account shall bear the same ratio to the total amount of the refund as the amount of funds provided to the student from each program up to the time of his withdrawal bears to the total amount of the student's educational costs for the payment period for which the refund applies, less any earnings from employment during that period. Expressed as a ratio, the amount of the refund to be attributed to each grant or loan aid source is as follows:

(Amount to be attributed to each program/total amount of institutional refund) : (amount provided by each program/student's cost of education for the period for which aid was awarded, minus amount of student earnings during the period).

(b) The portion of the institutional refund to be restored or credited shall be computed as follows:

(1)(i) Determine the amount of the student's cost of education for the payment period for which the refund applies, and subtract any portion of that cost which was met by the student with earnings from the college work-study program or other employment occuring during the payment period for which the refund applies.

(2) Determine the amount of funds from each program authorized under title IV, other than the college work-study program, which were disbursed to the student or credited to the student's account to meet his or her costs of education for the payment period for which the refund applies

(3) Divide each of the amounts in subparagraph (2) of this paragraph by the amount determined in subparagraph (1) of this paragraph to determine the percentage which each funding source constitutes of the aggregate amount applied to the student's educational costs.

(4) Multiply the percentages computed in subparagraph (3) of this paragraph by the amount of the institutional refund to determine the portion of the refund to be allocated to each aid program.

(c) The amount of the institutional refund which remains after the amounts computed in paragraph (b) of this section have been subtracted and restored to the appropriate aid account may be attributed to the expected family contribution. However, before any remaining funds may be returned to the student the institution must first, in accordance with paragraph (d) of this section, apply those funds against any funds that were disbursed directly to the student for that period under the basic grant, supplemental grant, national direct and guaranteed student loan programs, which the institution determines, were not used for educational costs. The institution must then transfer any remainder to the lender if the student received a guaranteed student loan and agreed to assign any refund to the lender to reduce the principal balance on his loan. (Appendix C contains an example demonstrating the method of computing the apportionment of an institutional refund outlined in this section.)

(d) *Attribution of repayments of cash disbursements made directly to the student.* (1) If a student officially or unofficially withdraws from or is expelled by an institution prior to the first day of classes of a payment period, any cash disbursements made to that student for noninstitutional costs under any title IV program (except the college work-study program) for that period is an overpayment.

(2) If a student officially or unofficially withdraws from or is expelled by an institution on or after the first day of classes of a payment period, and the student received a cash disbursement

for noninstitutional costs under any title IV program (except the college work-study program) for that period, the institution must determine whether a portion of that cash disbursement is an overpayment.

(3) In determining whether a student received an overpayment in the situation described in subparagraph (2) of this paragraph, the institution shall take into account the educational costs incurred by the student for noninstitutional charges for that payment period up to the date of withdrawal or expulsion. The institution shall then subtract that amount from the cash disbursements received by the student for that period. A ramainder indicates that an overpayment was received. Noninstitutional costs may include but are not limited to room and board, books and supplies, transportation and miscellaneous expenses.

(4) The portion of the overpayment attributable to each program shall be computed using the following ratio:

(Amount to be attributed to each program/total amount of cash disbursement determined by the institution to be an overpayment) : (amount provided by each program for the period for which aid is awarded/student's cost of education for the period for which aid was awarded minus amount of student earnings during the period).

(20 U.S.C. 1088f-1.)

§ 168.18 Additional factors for evaluating administrative capability and financial responsibility.

(a) The following conditions may impair an institution's ability to be financially responsible or to be capable of properly administering student financial aid programs authorized under title IV:

(1) If the principal amount of defaulted loans made to students at an institution under the guaranteed student loan program or the national direct student loan program represents more than 20 percent of the principal of all such loans which has reached the repayment period,

(2) For an institution which has a common academic year for a majority of its students:

(i) If more than 33 percent of the students who are enrolled at the beginning of an academic year withdraw from enrollment at that institution during that academic year, or

(ii) If more than 50 percent of the students who are enrolled at the beginning of an academic year receive loans under the guaranteed student loan program for that year,

(3) For an institution which does not have a common academic year for a majority of its students,

(i) If more than 33 percent of the students enrolled at the beginning of any 8-month period withdraw during that period, or

(ii) If more than 50 percent of the students enrolled at the beginning of any 8-month period receive loans under the guaranteed student loan program for that year,

(4) For an institution utilizing accrual accounting in their last Fiscal Year,

(i) If the institution's ratio of current assets to current liabilities is less than 1:1,

(ii) If the institution has a deficit net worth. Deficit net worth is defined as a condition where the liabilities of the institution exceed its assets, or

(iii) If the institution has a history of operating losses.

(5) For an institution utilizing cash accounting in their last Fiscal Year,

(i) If their operating expenses exceed revenue,

(ii) If the institution has a deficit net worth as defined in § 168.18(4) or

(iii) If the institution has a history of operating losses.

(6) For an institution utilizing fund accounting, if the unrestricted current or operating fund reflects a deficit at the conclusion of its most recent Fiscal Year,

(7) For the purpose of making this determination the institution will make available to the Commissioner, upon a reasonable request, its latest financial statement prepared by a certified public account or the most reasonable equivalent thereof.

(b) If the Commissioner has reason to believe that the conditions set forth in paragraph (a) of this section exist at an institution or if the institution changes ownership, the Commissioner may require the institution to submit for its latest fiscal year a financial statement or an audit prepared by a State or local audit agency for a public institution, or certified by a certified public accountant or licensed public accountant for a nonpublic institution. The financial statement or audit must include, at least, a balance sheet and an operating statement (profit and loss statement covering both income and expenses), and it must be signed by a duly authorized officer of the institution attesting to its accuracy as of the date of the statement. The date of the statement must be within 12 months of the date of the application.

(c) If the Commissioner determines that any of the conditions described in paragraph (a) of this section impairs the capability of the institution to administer any financial aid program authorized under title IV, the Commissioner may require the institution to take reasonable and appropriate measures to alleviate those conditions as a requirement for its continued participation in those programs. Before initiating such an action, the Commissioner will inform the institution of the findings and provide it a reasonable period to respond. That period will be at least 35 days. The institution's response may indicate that the conditions do not have an adverse affect on the administration of the programs, or the response may be to submit a plan of the action it will take to alleviate those conditions.

(20 U.S.C. 1088f-1.)

Subpart C—Misrepresentation

§ 168.31 Scope and purpose.

This subpart establishes the standards and rules under which the Commissioner may initiate suspension or termination proceedings against an otherwise eligible institution for any substantial misrepresentation made by that institution regarding the nature of its educational program, its financial charges, or the employability of its graduates.

(20 U.S.C. 1088f-1(c).)

§ 168.32 Special definitions.

"Misrepresentation" means any erroneous or misleading statement an otherwise eligible institution makes to a student enrolled at the institution, to any prospective student, to the family of an enrolled or prospective student, or to the Commissioner.

"Prospective student" means any individual who has contacted an otherwise eligible institution for the purpose of requesting information about enrolling at the institution or who has been contacted directly by the institution or indirectly through general advertising about enrolling at the school.

"Substantial misrepresentation" means any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person's detriment.

(20 U.S.C. 1088f-1(c).)

§ 168.33 Nature of educational program.

Misrepresentation by an institution of the nature of its educational program includes, but is not limited to, false or misleading statements concerning:

(a) The nature and extent of the institution's accreditation;

(b) Whether course credits earned at the institution may be transferred to any other institution;

(c) Whether successful completion of a course of instruction qualifies a student for:

(1) Acceptance into a labor union or similar organization; or

(2) Receipt of a local, State, or Federal license or nongovernmental certification which is required as a precondition for employment or to perform certain functions;

(d) Whether its courses are recommended (1) by vocational counselors, high schools, or employment agencies; or (2) for acceptance for governmental employment,

(e) Its size, location, facilities, or equipment;

(f) The availability, frequency, and appropriateness of its courses and programs to the employment objectives which it states its programs are designed to meet;

(g) The nature, age, and availability of its training devices or equipment, and their appropriateness to the employment objectives which it states its programs and courses are designed to meet;

(h) The number, availability, and qualifications, including the training and experience, of its faculty and other personnel;

(i) The availability of part-time employment or other forms of financial assistance;

(j) The nature and availability of any tutorial or specialized instruction, guidance and counseling, or other supplemantary assistance it will provide its students either before, during, or after the completion of a course; or

(k) The nature or extent if any prerequisites established for enrollment in any course.

(20 U.S.C. 1088f-1(c).)

§ 168.34 Nature of financial charges.

Misrepresentation by an institution of the nature of its financial charges includes, but is not limited to, false or misleading statements concerning:

(a) Offers of scholarships to pay all or part of a course charge, unless a scholarship is actually applied to reduce a charge which is made known is advance to an applied to all students not receiving such a scholarship; or

(b) Whether a particular charge is the usual and customary charge for a course.

(20 U.S.C. 1088f—(c).)

§ 168.35 Employability of graduates.

Misrepresentations by an institution regarding the employability of its graduates includes, but is not limited to, false or misleading statements—

(a) That the institution is connected with any governmental organization, or is an employment agency or other agency providing governmentally authorized training leading directly to employment;

(b) That the institution maintains a placement service for graduates or will otherwise secure or assist its graduates to obtain employment, unless it provides the student with a clear and accurate description of the extent and nature of this service or assistance and unless it actually provides the service or assistance; or

(c) Concerning Government job market statistics in relation to the potential placement of its graduates.

(20 U.S.C. 1088f-1(c).)

§ 168.36 Endorsement and testimonials.

Endorsement and testimonials which are not given voluntarily or which do not describe current practices and conditions of the institution will be viewed as misrepresentations by the Commissioner.

(20 U.S.C. 1088f-1(c).)

§ 168.37 Procedures.

(a) The designated OE official, as defined in subpart H, will, upon receipt of written allegations or complaints from students, prospective students, the family of students or prospective students, or governmental officials, review the allegations or complaints to determine their factual base and seriousness.

(b) If the misrepresentations are of a minor nature and can be readily corrected, the designated OE official will inform the institution and endeavor to obtain an informal, voluntary correction.

(c) If the designated OE official finds that the complaints or allegations relate to substantial misrepresentations as to the nature of the educational programs, the financial charges of the institution, or the employability of its graduates, the designated OE official will initiate action to suspend, limit, or terminate the institution's eligibility according to the procedure set forth in subpart H, or will take other appropriate action.

(20 U.S.C. 1088f-1(c).)

APPENDIX A—*Standards for Audit of Governmental Organizations, Programs, Activities, and Functions (GAO)*

PART III, CHAPTER 3—INDEPENDENCE

(a) The third general standard for governmental auditing is:

> In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.

(b) This standard places upon the auditor and the audit organization the responsibility for maintaining sufficient independence so that their opinions, conclusions, judgments, and recommendations will be impartial. If the auditor is not sufficiently independent to produce unbiased opinions, conclusions, and judgments, he should state in a prominent place in the audit report his relationship with the organization or officials being audited.[1]

(c) The auditor should consider not only whether his or her own attitudes and beliefs permit him or her to be independent but also whether there is anything about his or her situation which would lead others to question his or her independence. Both situations deserve consideration since it is important not only that the auditor be, in fact, independent and impartial but also that other persons will consider him or her so.

(d) There are three general classes of impairments that the auditor needs to consider; these are personal, external, and organizational impairments. If one or more of these are of such significance as to affect the auditor's ability to perform his or her work and report its results impartially, he or she should decline to perform the audit or indicate in the report that he or she was not fully independent.

PERSONAL IMPAIRMENTS

There are some circumstances in which an auditor cannot be impartial because of his or her views or his or her personal situation. These circumstances might include:

1. Relationships of an official, professional, and/or personal nature that might cause the auditor to limit the extent or character of the inquiry, to limit disclosure, or to weaken his or her findings in any way.

2. Preconceived ideas about the objectives or quality of a paritícular operation or personal likes or dislikes of individuals, groups, or objectives of a particular program.

3. Previous involvement in a decisionmaking or management capacity in the operations of the governmental entity or program being audited.

4. Biases and prejudices, including those induced by political or social convictions, which result from employment in or loyalty to a particular group, entity, or level of government.

5. Actual or potential restrictive influence when the auditor performs preaudit work and subsequently performs a post audit.

6. Financial interest, direct or indirect, in an organization or facility which is benefiting from the audited programs.

EXTERNAL IMPAIRMENTS

External factors can restrict the audit or impinge on the auditor's ability to form independent and objective opinions and conclusions. For example, under the following conditions either the audit itself could be adversely affected or the auditor would not have complete freedom to make an independent judgment.[2]

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[1] If the auditor is not fully independent because he or she is an employee of the audited entity, it will be adequate disclosure to so indicate. If the auditor is a practicing certified public accountant, his or her conduct should be governed by the AICPA "Statements on Auditing Procedure."

[2] Some of these situations may constitute justifiable limitations on the scope of the work. In such cases the limitation should be identified in the auditor's report.

1. Interference or other influence that improperly or imprudently eliminates, restricts, or modifies the scope or character of the audit.

2. Interference with the selection or application of audit procedures of the selection of activities to be examined.

3. Denial of access to such sources of information as books, records, and supporting documents or denial of opportunity to obtain explanations by officials and employees of the governmental organization, program, or activity under audit.

4. Interference in the assignment of personnel to the audit task.

5. Retaliatory restrictions placed on funds or other resources dedicated to the audit operation.

6. Activity to overrule or significantly influence the auditor's judgment as to the appropriate content of the audit report.

7. Influences that place the auditor's continued employment in jeopardy for reasons other than competency or the need for audit services.

8. Unreasonable restriction on the time allowed to competently complete an audit assignment.

ORGANIZATIONAL IMPAIRMENTS

(a) The auditor's independence can be affected by his or her place within the organizational structure of governments. Auditors employed by Federal, State, or local government units may be subject to policy direction from superiors who are involved either directly or indirectly in the government management process. To achieve maximum independence such auditors and the audit organization itself not only should report to the highest practicable echelon within their government but should be organizationally located outside the line-management function of the entity under audit.

(b) These auditors should also be sufficiently removed from political pressures to ensure that they can conduct their auditing objectively and can report their conclusions completely without fear of censure. Whenever feasible they should be under a system which will place decisions on compensation, training, job tenure, and advancement on a merit basis.

(c) When independent public accountants or other independent professionals are engaged to perform work that includes inquiries into compliance with applicable laws and regulations, efficiency and economy of operations, or achievement of program results, they should be engaged by someone other than the officials responsible for the direction of the effort being audited. This practice removes the pressures that may result if the auditor must criticize the performance of those by whom he or she was engaged. To remove this obstacle to independence, governments should arrange to have such auditors engaged by officials not directly involved in operations to be audited.

APPENDIX B.—*Standards for Audit of Governmental Organizations, Programs, Activities, and Functions (GAO).*

QUALIFICATIONS OF INDEPENDENT AUDITORS ENGAGED BY GOVERNMENTAL ORGANIZATIONS

(A) When outside auditors are engaged for assignments requiring the expression of an opinion on financial reports of governmental organizations, only fully qualified public accountants should be employed. The type of qualifications, as stated by the Comptroller General deemed necessary for financial audits of governmental organizations and programs is quoted below:

"Such audits shall be conducted * * * by independent certified public accountants or by independent licensed public accountants, licensed on or before December 31, 1970, who are certified or licensed by a regulatory authority of a State or other political subdivision of the United States: Except that independent public accountants licensed to practice by such regulatory authority after December 31, 1970, and persons who although not so certified or licensed, meet, in the opinion of the Secretary, standards of education and experience representative of the highest prescribed by the licensing authorities of the several States which provide for the continuing licensing of public accountants and which are prescribed by the Secretary in appropriate regulations may perform such audits until December 31, 1975; *Provided*, That if the Secretary deems it necessary in the public interest, he may prescribe by regulation higher standards than those required for the practice of public accountancy by the regulatory authorities of the States." [3]

(b) The standards for examination and evaluation require consideration of applicable laws and regulations in the auditor's examination. The standards for reporting require a statement in the auditor's report regarding any significant instances of noncompliance disclosed by his or her examination and evaluation work. What is to be included in this statement requires judgment. Significant instances of noncompliance, even those not resulting in legal liability to the audited entity, should be included. Minor procedural noncompliance need not be disclosed.

(c) Although the reporting standard is generally on an exception basis—that only noncompliance need be reported—it should be recognized that governmental entities often want positive statements regarding whether or not the auditor's tests disclosed instances of noncompliance. This is particularly true in grant programs where authorizing agencies frequently want assurance in the auditor's report that this matter has been considered. For such audits, auditors should obtain an understanding with the authorizing agency as to the extent to which such positive comments on compliance are desired. When coordinated audits are involved, the audit program should specify the extent of comments that the auditor is to make regarding compliance.

(d) When noncompliance is reported, the auditor should place the findings in proper perspective. The extent of instances of noncompliance should be related to the number of cases examined to provide the reader with a basis for judging the prevalence of noncompliance.

(The pamphlet "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" is for sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402. Stock number 2000-00110. Price: 85 cents.)

[3] Letter (B-148144, Sept. 15, 1970) from the Comptroller General to the heads of Federal departments and agencies. The reference to "Secretary" means the head of the department or agency.

APPENDIX C

The following example demonstrates the method of computing the apportionment of an institutional refund outlined in §168.17(b). Assume the refund is $500.

EXAMPLE:

Cost of education for the period: $2,200 Institutional refund: $500

Minus portion of cost met with student's payment period earnings - 200

$2,000

Aid Program	Amount of financial aid for the period for which the refund applies		Cost of education minus portion met with student's earnings		Percentage		Total Refund		Amount to be restored to aid program account
Basic Grant	$ 250	÷	$2,000	=	12.5%	x	$500	=	$62.50
Supplemental Grant	750	÷	2,000	=	37.5%	x	500	=	187.50
Student Loan (NDSL or GSL)	550	÷	2,000	=	27.5%	x	500	=	137.50
									$387.50

Total refund..... $500.00

Amount restored to aid programs..... - 387.50

Amount to be applied against (1) repayment of Basic Grant or Supplemental Grant funds disbursed directly to the student and (2) reduction of the principal amount of National Direct or Guaranteed Student Loans disbursed directly to the student, for that period, and any remainder returned directly to the student as indicated in §168.17(c)..... $112.50

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